Farmland Ownership Restrictions: Between a Rock and a Hard Place

Peter N Bell

University of Victoria

2014

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January 16, 2014

Introduction

This paper is the output from collaboration with the Canadian Federation of Agriculture (CFA). After I presented a poster at the Canadian Agricultural Policy Conference in 2013, the CFA contacted me to discuss a resolution put forward by the Agricultural Producers of Saskatchewan (APAS), requesting that "*the CFA initiate a comprehensive study of the implications of provincial land ownership regulations on farmland investment*" (BRM4-20 – The Impact of Non-Farmer Farmland Investment on Farmland Value, 2013). I have written this paper for a policy-focused audience as part of such a comprehensive study.

This report is part of my PhD research activities in Canadian agriculture and finance. I gratefully acknowledge support from the Social Science and Humanities Research Council (SSHRC). The research presented here is the first of several publications that I plan to release on ownership restrictions and Saskatchewan (SK) farmland. My subsequent papers will provide technical details on the model I use here, a new simulation method to estimate policy effects in a quasi-experimental setting, and estimation of the effects of the policy using data from Statistics Canada on provincial farmland prices. I plan to make each paper available on an open access network for economic researchers (MPRA).

This paper focuses on the unintended consequences of policy that restricts land ownership as seen through a basic economic model. Farmland ownership has earned much attention recently and I strive to say something new and insightful. The claims (and errors) presented here are my own.

What are FLP?

I use the term Farmland Limited Partnership (FLP) to describe certain entities that own farmland for investment purposes. The entities are often available only to accredited investors (often through exempt market dealers) that use a Limited Partnership corporate structure to separate those who provide investment capital from those who manage the investments. FLP do not farm the land themselves but earn returns through rental rates and capital gains. They are just one type of business model in the sophisticated global farmland investment industry, which is estimated at $14 billion (HighQuest Partners, 2010, p. 12).

The practices of farmland investors take different shapes around the world. In Australia, most investment is made by private and vertically-integrated agricultural companies. In contrast, there are exchange-traded farmland funds in parts of Eastern Europe (Highquest Partners, 2010). There are calls for exchange-traded farmland funds in Canada (Painter, 2009), but current policy in SK makes it infeasible (Farm Land Security Board, 2013a). Nonetheless, there is at least one publicly-traded company in Canada that owns farmland in SK: Ceres Global Ag Corp. has an exemption from the policy for land associated with its grain storage business (2013b).

Farmland investment in the USA "is typically a passive activity with farmland management functions subcontracted by the fund manager to an outside farm management firm" (HighQuest, 2010, p.1). Canada is a little far behind the USA in that regard because the LP corporate structure means the managers are often lead investors. As FLP begin to close and sell their portfolios, the Canadian farmland investment industry is starting to catch up with the USA and see more separation of ownership and management. For example, the Assiniboia FLP sold its entire portfolio to the Canada Pension Plan Investment Board (Assiniboia Capital Corp., 2013) but the Assiniboia management team will continue to operate the portfolio for the new owners.

Table 1: Description of three Canadian FLP

FLP Name	Description	Size
Agcapita Partners LP	Raised equity annually (5 LP since 2008), sell land from old fund to new funds and outsiders.	Approximately 45,000 acres worth \$50M across all 5 LP (Agcapita, 2009).
Assiniboia Farmland LP	Raised equity annually from 2005-2008, then combined in 2009. Sold entire portfolio in 2013.	Approximately 115,000 acres worth \$128M (Assiniboia, 2013).
Bonnefield Canadian Farmland LP	Raised equity in 2010 and twice in 2013.	Approximately 15,000 acres worth \$50M in LP1, \$24M in LP2 and \$200M in LP3 (Bonnefield, 2013)

Each of the three FLP in Table 1 have interesting details that deserve close inspection. However, I will focus on the story of Assiniboia FLP because they amassed the largest portfolio of farmland over several years and sold it in a single transaction. This is a successful execution of their business model, “to provide investors with a turn-key opportunity to gain exposure to Saskatchewan farmland with the stated intention of creating a liquidity event for investors within a reasonable window of time” (Assiniboia Capital Corp., 2013).

The actions of Assiniboia FLP resemble a basic type of securitization because they pooled farmland and sold the collection of land as a single asset. In the future FLP may engage in different types of securitization, such as selling financial derivatives based on farmland prices. These are important types of financial activity that can improve economic outcomes by facilitating transfer of risks, but they can also create systemic risks. For example, pooling mortgage assets with leverage introduced systemic risks into the global financial system leading to the global financial crisis (Fuji, 2010). Thankfully the FLP in Table 1 report using low leverage (such as Agcapita, 2009), which means FLP do not create significant systemic risks through leverage. However, other practices of FLP may create risks now or in the future. For example, if an FLP has a planned end date and management cannot find buyers for the portfolio then management may be forced to dump the assets on the market to negative effect.

There is further information available about FLP for the interested reader. I recommend the consolidated financial statements and management’s discussion from Assiniboia (2009), marketing documents from Agcapita that use classic ideas from investment theory such as Ben Graham’s idea for the margin of safety (Agcapita, 2009), and research published by Bonnefield Inc. (2013). There is also a large research literature that explores the benefit of farmland in a general investment portfolio, such as Painter and Eves (2008) who find that investors should (sometimes) hold more farmland than equities. There are even examples of exotic FLP, such as a company in the USA that converts farmland into certified organic land and earns premium returns through sustainable agricultural practices (Chris Martenson, 2012).

There are many competing narratives in the topic of farmland investment (further discussion on narratives in economics is provided by Hunt, 2014). Some of these narratives reflect demands from investors for assets that can mitigate risks of inflation and provide secure, physical assets in uncertain times. Other narratives reflect concerns that farmers are losing control over strategic assets with negative implications for national sovereignty or farming communities: “these investments contribute to the accelerating concentration of the ownership and utilization of farming resources… on another order of magnitude altogether” (Magnan and Sommerville, 2011). The tension around investment in agriculture is reflected in Saskatchewan policy that restricts foreign ownership in order “to afford protection to farmers against loss of their farm land” (The Province of Saskatchewan, 1977, p.8). In this paper I argue that policy meant to help farmers own land today can create conditions that make it difficult for them to keep the land in the future.

The FLP activity in SK raises many questions. For me, these are questions about the systemic effects of FLP activity: how does farmland investment affect the competitiveness and stability of the agricultural sector? The FLP arguably increase competitiveness because they provide a new source of capital for investment. Such investment may be beneficial if it used for productive assets but it may be harmful if used for financial gamesmanship. As FLP in Canada develop, it is important to seek balance between demands from investors driven by global conditions and the needs of a successful agricultural sector.

What is the Farm Security Act?

The Farm Security Act (FSA) is a policy in Saskatchewan that restricts farm ownership by certain groups. The law has changed several times and a comprehensive review is provided in Ferguson, Furtan, & Carlberg (2004). I provide a simplified version of the policy history in Table 2, which shows how Provincial, Canadian, and foreign buyers have each been affected in broad terms. The FSA is similar to other policy around Canada and the world (Stastna, 2012). There are examples of similar policy in the USA, which played a role in the largest-ever takeover of an American firm by a Chinese firm (Reuters, 2013). Similar policy in China also made the cover page of The Economist (“Chinese Land Reform Policy”, 2013). Restricting access to land ownership seems to be a ubiquitous policy phenomenon that raises questions around concepts of liberty as seen through legal rights to own property.

Table 2: Description of FSA Policy over time

Time	Domestic Demand (Allowed entities)	Foreign Demand (Restricted entities)
Pre 1974	Provincial, Canadian, and Foreign	None
1974-2002	Provincial	Canadian and Foreign
2002-Present	Provincial and Canadian	Foreign

For economists, the FSA policy affects the “depth of the market” at auction. The first peer reviewed paper on the policy was written by Jared Carlberg, who used auction theory to argue that policy causes lower prices because it reduces the number of bidders in market (2002, p. 351). I use a similar model with demand and supply for a representative acre of farmland. My model separates buyers into two groups: those allowed into the market (domestic) and those who are not (foreign). I analyze the policy by changing how Provincial, Canadian, and foreign buyers are separated into these groups over time, as described in Table 2.

My model provides a way to calculate if the FSA passes a Net Benefit Test. These Tests are politically charged because they play an important role in Federal Government decisions on foreign investment in Canada. Although the Tests are criticized for being opaque (Reguly, 2013), they are a basic feature of neoclassical economic models. In my model, the policy always benefits domestic buyers through lower prices and hurts foreign buyers by excluding them. It follows that the: *the policy passes the Net Benefit Test when domestic demand is larger than foreign; the policy fails the Test when foreign demand is larger than domestic.* This Test is derived under simplified assumptions that domestic and foreign buyers have similar marginal behaviour; what matters in my model is the total size of domestic and foreign demand. Although this Test is very simple, it can generate new insights into the effects of policy within my economic model by changing the definition of domestic and foreign buyers in line with Table 2.

How are FLP and the FSA related?

I begin with a legal interpretation of the FSA that focuses on institutional incentives and constraints. When the FSA started, only provincial entities could own farmland. I infer that only capital based in SK could be used to own SK farmland (I do not consider debt arrangements). When the FSA changed in 2002, any Canadian entity could own SK farmland. This means a larger pool of capital could be directed towards ownership of SK farmland but as investors tried to enter the SK farmland market, they found few vehicles to facilitate investment. The international farmland fund industry still could not participate in the SK market, even after the 2002 policy change. FLP have developed as a made-in-Canada solution to the question: how do we invest in Saskatchewan farmland? Thus, the 2002 policy change created incentives for FLP growth because it increased demand (pool of eligible investors) and restricted supply (global farmland management companies) for farmland investment services.

For the remainder of paper, I use my model to generate a thought experiment. This experiment attempts to rationalize past policy decisions and anticipate future scenarios. The experiment is meant to be read with the Graphical Summary included in an appendix. I will refer to things in the Graphical Summary (Point A – D) throughout the explanation. To begin, I state two results from my model that are important for the thought experiment in Table 3.

Table 3: Review of Key Facts from Model

Facts	Explanation
Policy passes a Net Benefit Test when domestic demand is larger than foreign.	Policy benefits domestic and hurts foreign demand – when domestic demand is larger, the policy has a net benefit.
Policy causes underpricing when foreign demand increases faster than domestic demand.	If foreign demand is growing faster than domestic, then removing foreign will slow down growth overall.

Starting at Point A. Suppose it is 1970 and demand for SK farmland from provincial residents is larger than the rest of Canada and foreigners combined. If we define domestic demand as provincial residents, as in Table 2, then the FSA policy has a net benefit, as in Table 3. The policy will pass the Net Benefit Test because domestic demand is larger than foreign and the policy will have political support because it benefits domestic buyers (voters). This shows that my model can rationalize the choice to start the FSA policy in 1974 (although it cannot explain why the Province didn't start the policy earlier).

Moving from Point A to Point B. Suppose there was a broad trend of globalization from 1974-1994, which implies that demand for farmland from provincial entities grows more slowly than demand from the rest of Canada and foreign entities. It follows that SK farmland prices would increase less quickly than they would without the policy – over time SK farmland becomes underpriced. Furthermore, the foreign demand grows relative to domestic and the size of the Net Benefit of the FSA policy decreases over time.

Starting at Point B. Suppose that the trend of globalization culminates in 2000 with a situation where demand for SK farmland is larger from entities outside the province than from those inside the province. Under the definition of the FSA policy in Table 2, this would imply that foreign demand was larger than domestic demand and the policy would fail the Net Benefit Test. There would be calls to remove the policy. However, if the Province removes the FSA then they risk unleashing large pent-up demand that could destabilize the market and rural communities. This would be politically costly because it is exactly the sort of thing that policy was created to avoid.

Moving from Point B to Point C. In 2002, the Province revised the FSA. As in Table 2, they effectively redefined domestic and foreign demand, allowing Canadian entities to own land. This suggests some ingenuity on the part of policy makers because it allowed them to change the relative sizes of domestic and foreign demand: before 2002 the domestic demand was smaller than foreign and the policy had a net cost; after 2002 domestic demand was larger than foreign and the policy had a net benefit. By redefining the rules, the policy makers could keep some restriction on ownership and mitigate the social cost of the policy that developed during the period of globalization. The 2002 policy change instantly changed the equilibrium in my model, increasing total benefits available to farmland owners in terms of economic surplus. In my thought experiment, the market can take some time to adjust to the new equilibrium. FLP were part of that adjusting process.

Starting at Point C. Changes to the FSA in 2002 that allowed wholly Canadian entities to once again own farmland in SK meant that prices would rise faster in the following years than they would otherwise as pent-up demand entered the market. This created an incentive for land owners who could help facilitate new types of investment in farmland. FLP were well positioned to provide that service. Now it may be that the market has reached a new equilibrium as FLP begin to sell their portfolios, the new surplus has been created and captured (in part) by FLP and the economic surplus associated with owning and renting land is being transferred to different investors.

Since 2008, SK prices have increased more quickly than AB or MB (Stastna, 2012). This is due to many factors, such as crop yields and interest rates but in terms of my model it suggests that domestic demand for farmland has increased faster than foreign, which seems fair because the Canadian financial system avoided much of the worst trouble in the Global Financial Crisis in 2008. Further, it implies that the net benefit of the policy has increased since the 2002 policy change, which is encouraging for policy makers. However, the Province should be aware of potential risks if it finds itself in a situation where foreign demand is larger than domestic because it cannot repeat the 2002 policy change – relaxing the FSA further will require allowing some foreign ownership. Under certain conditions in the future, the policy will fail the Test again and policymakers will face a difficult situation (Point D).

Moving from Point C to Point D. If there is strong growth in foreign demand for Canadian farmland again in the future, then it is possible that foreign demand will once-again exceed domestic demand in my model. This could happen in an up-market if foreign demand grows faster than domestic for an extended period, or a down-market if foreign decreases less quickly. Either way, the policy will fail the Net Benefit Test when foreign demand is larger than domestic. When this happened in 2002, policy makers responded by redefining foreign and domestic – they allowed the rest of Canada to join the domestic category. This change allowed some pent-up demand into the market and led to growth in the FLP market, which foreshadows the implications of further relaxing the policy.

Starting at Point D. In the future the Province will face an incentive to remove the FSA policy because of the net social cost and an incentive to keep the policy because of the large pent-up foreign demand – they will be stuck between a rock and a hard place. If policy makers remove the policy completely then they will allow the entire global farmland industry to enter the SK market. This would have effects that run against the original spirit of the policy, which was to protect and preserve rural communities (Farm Land Security Board, 2013a). However, if they keep the policy then they suffer net social cost because it fails the Net Benefit Test. Neither keeping nor removing the policy are good options and this would be a regrettable situation where policy meant to protect rural communities ends up undermining them.

One policy option at Point D would be to relax the foreign restriction but not remove them, similar to the policy change in 2002. This would provide a sort of pressure-release valve to allow some foreign access without allowing it all in at once. For example, entities that are at least 50% Canadian could be allowed. This raises some challenges for implementation and oversight that could be cumbersome for the provincial authorities, but it may be a middle path in a situation where there are no good choices. Furthermore, it may be wise to take this policy action now, when the policy has a net benefit in order to avoid this tough position in the future.

Summary of Analysis

What are Farmland Limited Partnerships?

- Limited Partnerships focused on farmland ownership. They are somewhat unique to Canada because they are marketed to accredited investors, but they are starting to resemble their global peers by selling portfolios of land to institutional investors.

What is the Farm Security Act?

- A policy that restricts ownership of farmland in Saskatchewan for certain entities. The policy started in 1974 to restrict ownership to Provincial entities. The policy changed in 2002 to allow ownership by Canadian entities.

How are they related?

- From an institutional perspective, the 2002 policy change allowed FLP to grow by using investment capital from other provinces.
- From the perspective of my economic model, the policy created pent-up demand from 1974-2002. With policy change in 2002, some of this demand was released into the market and caused growth in FLP. This foreshadows implications for further changes to (relaxing) policy. Policy makers cannot exactly repeat the 2002 policy change; future policy changes will allow some foreign access, which introduces risk of large investment inflows from pent-up foreign demand.

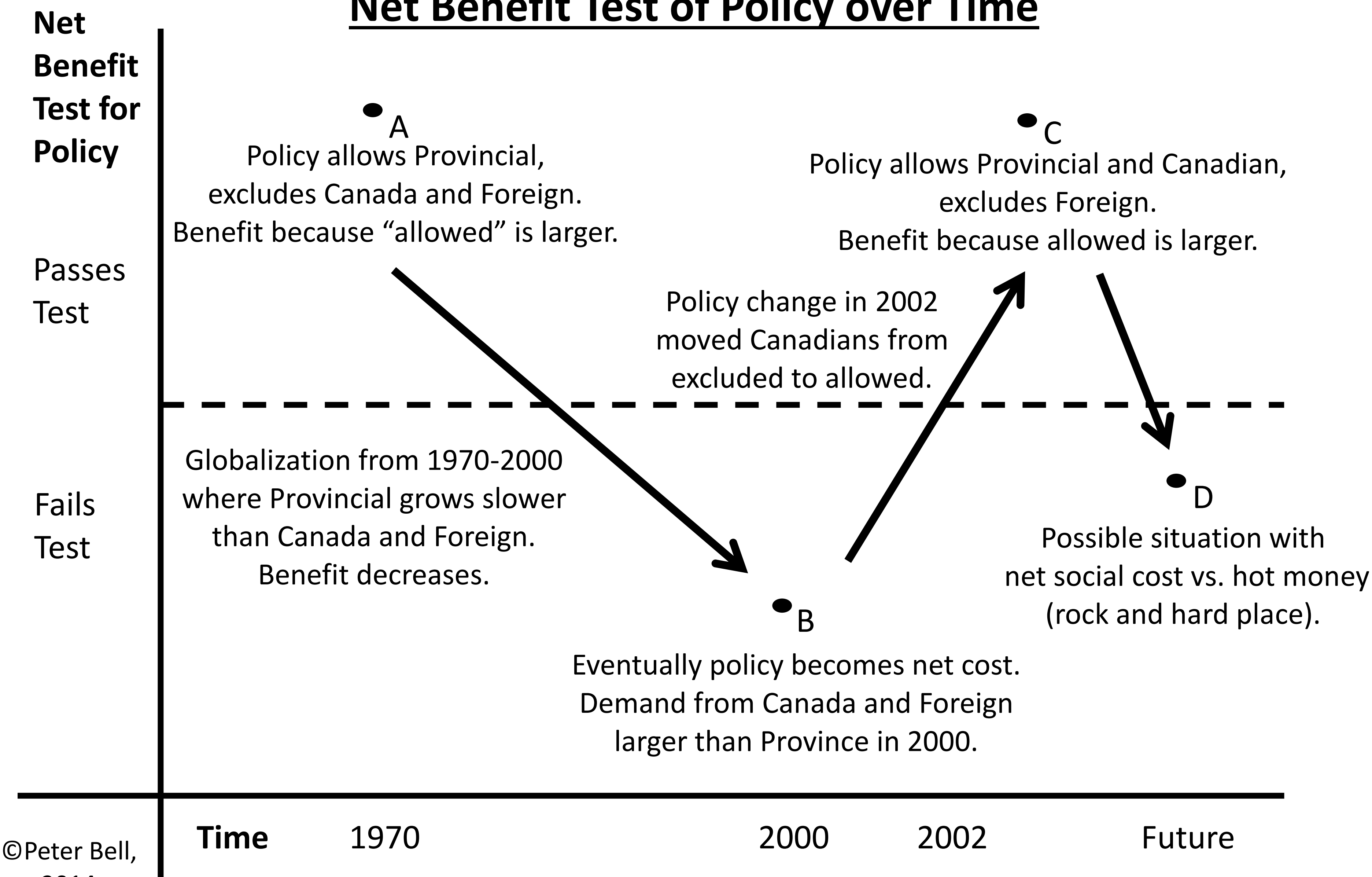
What next?

- I plan to release three papers that build on the model I use here. The first paper will describe the technical details of my model. The second will describe a new method to simulate the effects of policy. The third will estimate the effects of policy.

Possible future projects:

1- Further comparison of land ownership policy across Western Canada.
2- Empirical extension of my model using data on individual farmland sales.
3- Discussion of different types of FLP, potential for financial derivatives based on farmland, and implications for agricultural sector.
4- New methods to assist with policy enforcement.

Graphical Summary: Net Benefit Test of Policy over Time



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